obliquity was corrected, however, in *Hall* v. *Otis*,[26] in 1885, in which case the rule of *Knatchbull* v. *Hallett* was applied.

Nevertheless, the principles contended for herein are supported by a very respectable minority and by reasons that appear to us unanswerable. It is evident, too, that many of the courts are growing restive under the inadequate test that precedent has laid down for them. Accordingly, it is confidently hoped that, having now rested, equity will soon take this next stride forward toward ultimate perfection.

H. L. W.

WHAT IS A DISCOUNTING?—If Smith is the holder of a negotiable note for $1,000.00, due in one year, he may go into the First National Bank, indorse the note, and transfer it to the cashier, who would give him the face value less 6% for the time that the note had to run, or $940.00. Now this Smith would tell the first friend he encountered that he had "discounted" the note. And the judge of the appellate court would, upon seeing these facts on the record, likewise pronounce this to have been a discounting of the note. But suppose that Smith had not indorsed the note. Would that alter the nature of the transaction? Or suppose that instead of getting $940.00 for the note, Smith had asked the cashier, "What will you give me for it?" The cashier after looking at the name on the paper would probably offer Smith $900.00. Smith would then indorse the note and hand it to the cashier. What is that transaction? Is that a discounting?

In the first example of the transfer of the note, which was agreed to be a discounting, there where two elements: (a) an indorsement, and (b) a price arrived at by figuring so much percent off the face value of the note for the time that it had to run. Must both of these elements be present to constitute the transfer a discounting, or only one?

Let us first look at the method of determining the price. Is this counting off of a certain percentage a necessary element of a discounting? The ordinary man would, I think, say that it is. Discount is defined as a deduction made for interest, in advancing money upon, or purchasing, a bill or note not due; payment in advance of interest upon money.[1] Common sense would say that the verb "to discount" would mean nothing more than a transfer or a sale at a discount. The idea of an advance in the nature of interest is, in the lay mind, inseparably connected with a discounting. And this argument from the common acceptance of the English language is in accord with the decisions reached in the adjudicated cases.[2]

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[26] *Supra*, note 2.

[1] WEBSTER'S NEW INTERNATIONAL DICTIONARY (1920).

[2] Fleckner *v.* Bank of U. S., 8 Wheat. 338, 5 L. Ed. 631 (1823); Bank *v.* Johnson, 104 U. S. 271, 26 L. Ed. 742 (1881); Danforth *v.* Bank, 48 Fed. 271, 1 C. C. A. 62, 17 L. R. A. 622 (1891); Morris *v.* Third National

There is a vast amount of contradictory *dicta,* but very few actual decisions. And of this latter group, none is dangerous and only one in point.[3] In that case, a bank bought a note at one dollar less than its face value, which the court held to be a discounting, because the note was indorsed—a curious gambling of elements, as we shall see. No authority was cited except the definition of discount in Bouvier's dictionary and an early Kentucky case.[4]

The remaining authority is only apparently contradictory. Thus, in a case where a bill was indorsed over to another at a lump sum, or market price, this was spoken of as a discount, but the question before the court was whether or not the transaction was an attempt to evade the usury laws.[5] Again, a bank authorized only to discount, bought a note at a fixed price and was allowed to recover on it; but this was only under a Massachusetts doctrine that the holder of a promissory note need not have the legal title to it in order to sue on it.[6] The judge, in his opinion, points out that in the absence of that peculiar doctrine there could have been no recovery because the purchase at a fixed sum was beyond the powers of the bank.[7] In another case, it was held that the purchase of a negotiable note at a lump sum was within the powers of a bank authorized to carry on the business of discounting notes.[8] A distinction was drawn between "discounting" and "carrying on a banking business by discounting", which latter was said to be always in the nature of a loan, while we shall see that it seems doubtful if it could ever be a loan. At any rate the Court sustained as proper for a bank with the first class of powers, a transaction which concerned a note indorsed without recourse that really amounted to pure speculation in commercial paper. The next year the Maryland Court followed this distinction and declared that it was beyond the power of a bank to purchase at a discount a note not indorsed by the holder, when the bank's charter only authorized it to carry on the business of banking by discounting promissory notes.[9] But this case is really in contradiction to the proposition that an essential element of a discounting is that the price must be figured on a percentage basis for the time that the instru-

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Bank, 142 Fed. 25, 73 C. C. A. 211 (1905); writ of *certiorari* denied, 201 U. S. 649, 50 L. Ed. 905 (1906); Smith *v.* Exchange Bank, 26 Ohio St., 141 (1875); F. & M. Bank *v.* Baldwin, 23 Min. 198, 23 Am. Rep. 683 (1876); First Nat. Bank of Rochester *v.* Pierson, 24 Min. 140, 31 Am. Rep. 341 (1877).

[3] Nicholson *v.* Bank, 92 Ky. 251, 17 S. W. 627. 13 Ky. Law Rep. 478, 16 L. R. A. 223 (1891).

[4] Triplett *v.* Holly, 4 Litt. (Ky.) 131.

[5] McElwee *v.* Collins, 20 N. C. 209 (1831).

[6] Nat. Pemberton Bank *v.* Porter, 125 Mass. 333, 28 Am. Rep. 235 (1878).

[7] F. & M. National Bank *v.* Baldwin, *supra;* First National Bank of Rochester *v.* Pierson, *supra.*

[8] Pape *v.* Bank, 20 Kan. 440, 27 Am. Rep. 183 (1878).

[9] Lazear *v.* Nat. Union Bank, 52 Md. 78, 36 Am. Rep. 355 (1879).

ment has to run. It merely holds that this particular transaction, although characterized by the presence of this element, was not a discount. In fact the principal purpose of mentioning the case at all is to call attention to the excellence of the dissenting opinion, which states that to be a discounting the consideration must be figured on a percentage basis.

But what about the necessity for an indorsement? Is that also a requisite of a valid discounting? By the better view it is not, although the courts have become confused for the reason that an indorsement is usually made on a transfer at a discount. But clearly if we revert to reason it would seem that an indorsement is nothing more than an usual incident. Had the supposititious Smith transfered his note to the bank without assuming the indorser's liability and received for the transfer the thousand dollars less a discount of six per cent, he would, no doubt, have called it a discounting. And so would any other reasonable layman; for was it not a transaction at a discount? The courts also hold this in the few cases in which there is no indorsement.[10] There is, however much *dicta* to the contrary, but only one adjudicated case,[11] and that has just been discussed and recommended for the excellence of its dissenting opinion.

While it appears that an indorsement is not a necessary element of a discounting, it may be of interest to note the effect it has on the nature of a discounting. If the transferor does not indorse or indorses without recourse, the transaction in that case is in the nature of a sale, or properly would be called a sale by way of discount.[12] But if the transferor indorses, what then is the nature of the discounting? Is it a purchase at a discount with a guarantee, just as land sold is guaranteed by covenants of title? Or is it a loan with the interest paid in advance and the paper taken as security? The purchase of a claim payable at a fixed date for the face value less so much percent for the time it has to run and from one who guarantees payment is to all intents and purposes so closely allied to a loan on the claim purchased that it would not be profitable to draw any distinction, and the cases therefore constantly refer to this class of indorsed discounts as loans[13] and hold them to be within the usury laws.[14] To be strictly technical it should be remembered that the guarantee of the indorser is only conditional, that although the effect of such a discounting may be the advance of money to the indorser, still he is not the person primarily liable for its repayment and indeed may never be liable at all. Therefore it seems doubtful if a discounting can

[10] Danforth *v.* Bank, *supra;* Morrison *v.* Springfield Third Nat. Bank, *supra.*

[11] Lazear *v.* Nat. Union Bank, *supra.*

[12] McElwee *v.* Collins, *supra;* Danforth *v.* Bank, *supra.* *Ex parte* Roberts, 2 Cox 171 (1789).

[13] Fleckner *v.* Bank of U. S., *supra.*

[14] Smith *v.* Exchange Bank, *supra;* Massa *v.* Dauling, 2 Strange 1243 (1746); Niagara Co. *v.* Baker, 15 Ohio St. 68 (1864).

ever really be a loan, although if indorsed it amounts to such for all practical purposes, while if unindorsed it is a purchase at a discount. Granting that it might be a loan, whether or not a given discounting is a loan or a purchase would really depend in each case on the intent of the parties—an intent of which they would hardly be conscious themselves, and which no court could be expected to determine under existing means of proof.

Whatever may be the purely logical side, in practical effect the discounting of an indorsed note amounts to a loan, and to hold such a transaction without the scope of the usury laws would be to furnish an easy way of evading them.[15] Of course, where the statute puts a limit on the rate of discount, there is no need to indulge in the purely academic distinction as to whether or not the discounting in question be a loan or a purchase. All discounts transcending the terms of the statute, incur the penalty therein provided.

Now if the bank pays Smith $940.00 for his note, what difference does it make whether Smith and the cashier arrived at the price by deducting the interest from the face value, or by ordinary bargaining? Why is this distinction drawn? It becomes important for two reasons. In the first place, as we have just seen, a discount is within the laws regulating lawful interest, while a purchase at a market price is not. So the nature of the transaction may be of vital importance to one seeking recovery on a transfer where there was a great discrepancy between the face value and the price paid.

But the most important result of this distinction is reached in the case of banks. It is clearly desirable that banks should not be speculators in paper—mere note shaving institutions. It is also obviously necessary that they should have the power to acquire valid paper and advance money thereon. To prevent the evil and secure the advantage of negotiating notes, bills, etc., National Banks and most State Banks are authorized to discount[16] at a specific rate,[17] but are forbidden to buy and sell in an ordinary market.[18] If no such limits are set in the charter, then the general laws of that jurisdiction regulating interest apply. This double safeguard effectively prevents note shaving and speculating in evidences of debt, while it allows banks to advance money at a profitable rate on good negotiable paper.

B. C.

[15] See dissenting opinion of the Chancellor, Cram *v.* Hendricks, 7 Wend. (N. Y.) 569 (1831), for an exhaustive study of authorities. This opinion was confirmed in Bank *v.* Johnson, *supra.*

[16] U. S. Revised Statutes Sec. 5136.

[17] U. S. Revised Statutes Sec. 5197.

[18] U. S. Revised Statutes Sec. 5198.